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Dear Senators

Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009

Rio Tinto appreciates the opportunity to make this submission to the Senate Economics Legislation Committee on the *Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009* ("bill").

Changes to the current regime would be welcomed if they encourage companies to increase alignment between executive performance and long term sustainable growth of the company and limit the ability of Boards to reward poor performance. The regime would need to be administratively workable and equitable for all concerned, including executives retiring for reasons other than poor performance (such as redundancy).

Rio Tinto agrees that good governance practice would limit payments available to departing executives to an amount of one year's salary. As a company which is listed on the ASX and on the London Stock Exchange, Rio Tinto is subject to the requirements of the UK Combined Code which limits notice or contract periods for executive directors to one year. This limit is contained in the employment contracts of the chief executive and finance director of Rio Tinto and is part of the remuneration practice of Rio Tinto. Rio Tinto's stated policy is that compensation would not be provided for poor performance.

There are a number of areas where the bill would extend the requirements for shareholder approval beyond what is necessary to prevent payments for poor performance. We can see no benefit in asking shareholders to approve payments which are not contentious or which would be legally accrued entitlements. Shareholders are most concerned with the remuneration of the chief executive, other executive directors and perhaps a small number of senior executives.

In summary, our key issues are:

- **that the bill would extend beyond the key executives of the listed parent company, to management personnel of subsidiary operating companies;**
- **the proposed regulations that would contain the substance of the proposed regime are not yet available for comment and no Regulation Impact Statement is intended;**
- **genuine payments made to managers on resignation, retirement or redundancy as well as legitimate entitlements such as accrued annual leave and superannuation may require shareholder approval; and**
- **in many instances the bill would apply to existing contracts giving employers no opportunity to alter remuneration arrangements to align with its requirements.**

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Our specific submissions are as follows:

1. Shareholder approval requirement affects a wide population including directors of *unlisted* operating subsidiaries

The bill would extend requirement for shareholder approval to persons holding a 'managerial or executive office'. Although the Explanatory memorandum and Second reading speech state that this would cover all the executives named in the annual Remuneration report (key management personnel), the operation of amendments 7 and 19 of the bill extend this to directors and managers of subsidiaries and related bodies corporate. In Rio Tinto's case shareholder approval may be required in respect of termination payments for the directors of its listed subsidiaries and approximately 300 unlisted operating companies.

This latter category of directors are long serving general management and senior management of Rio Tinto who do not hold management or executive office at the listed parent company level and are not included in the Remuneration report. Their potential termination payments would not be of a quantum or nature to concern investors or be considered 'golden parachutes'. The consequence of the bill as drafted would be that shareholders may be asked to consider the termination payments made to a range of people who have minimal direct impact on the performance of Rio Tinto. This would have significant compliance costs, despite the Explanatory memorandum stating that these would be "Nil".

We strongly submit that the definition 'managerial or executive office' be limited to the chief executive, other executive directors and key management personnel of the *listed* parent company.

2. Shareholder approval may be required in circumstances where poor performance is not relevant, for example redundancy

Termination payments are made in a wide variety of circumstances, most of which do not relate to poor performance. The bill would treat *all* payments associated with terminations, whether due to dismissal, redundancy, resignation, retirement or death, in the same way. The consequence would be that shareholders may be asked to approve payments which relate to length of service (implicitly arising out of good performance) and payments made due to bona fide redundancy.

Positions may become redundant for a variety of reasons and occur at all levels. Redundancy payments are made subject to a company wide redundancy policy (as it applies in each country). In recent times we have seen senior executive positions made redundant due to company restructuring and the economic downturn or due to the industry contracting through mergers and acquisitions. These were genuine redundancies and did not relate to performance. In circumstances of genuine redundancy it is appropriate to make a redundancy payment in addition to the notice period, and we believe that our shareholders are supportive of that position.

Where a company policy applies broadly to employees, it would be inappropriate to discriminate against long-serving executives who are made redundant. For example, a senior executive may have a 12 month notice period and receive an additional payment based on a company policy reflecting 25 years service to the company (say of 50 weeks). Under the terms of the bill, a long-serving executive cannot be paid any more than one who has worked for the company for a very short period.

We believe that, subject to a company's redundancy policy being of wide-ranging application across the company, in the case of genuine redundancy, senior executives should be entitled to their benefits under the terms of that policy without this being included in the calculation of the termination "benefit". Taxation Ruling TR 2009/2 provides guidance as to when a payment

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made to a person whose employment is terminated qualifies for treatment as a genuine redundancy payment under section 83-175 of the *Income Tax Assessment Act 1997* (Cth). A genuine redundancy payment is one 'received by an employee who is dismissed from employment because the employee's position is genuinely redundant'.

Excluding payments for a genuine redundancy from the calculation of termination "benefit" would be consistent with the government's stated objective of curbing excessive "golden handshakes". Termination payments to chief executives or chief financial officers are of greatest interest, yet these positions are most unlikely to be subject to a genuine redundancy (other than as the result of a takeover).

Redundancy payments are structured to compensate long serving employees. Under a policy which applies to the workforce generally, a short term 'poor performer' would not receive a significant amount. Furthermore, a payment made at the end of a fixed period of employment cannot normally be a genuine redundancy payment. Termination "benefits" would still include payments in lieu of notice and all other ex gratia payments.

3. Definition of termination "benefit" should not include valid entitlements such as accrued leave

The 'excessive' termination payments quoted in the media are often more than just payments which relate solely to an executive's termination. The media headlines a figure which includes several other payments such as:

- accrued annual leave
- accrued long service leave
- the statutory superannuation contribution (as this is prescribed by law) and any superannuation contributions above the statutory amount made voluntarily (salary sacrifice)
- bonuses that have accrued over prior years but were not paid out until departure
- potential gains by exercising options or selling shares awarded in prior years as part of her or his remuneration.

These categories of payments made to departing executives are statutory or other legal entitlements which accrue to the person by virtue of long service or are their own personal accumulated entitlements. These are unrelated to performance and will already be provided for by the company or set aside for the person. For these reasons section 200H should be extended to clarify that these payments are excluded from the calculation of the termination "benefit". In particular, any superannuation (whether accumulated or defined benefit) or pension which has accrued over time should be excluded from the calculation, as should accrued leave entitlements.

As an international company, Rio Tinto employs people in accordance with the employment practices and laws of various countries' jurisdictions. The senior executives may be Australians with Australian statutory superannuation, but may equally be employed in the United Kingdom, Canada or the United States and have pension entitlements in those countries. It would make sense for the legislation to treat such a pension entitlement in the same way as superannuation in an accumulated or defined benefit fund which is governed by Australian law.

All superannuation and pension entitlements which have accrued to an executive over the period of employment <u>prior to the termination</u> should be excluded from the calculation of the termination "benefit". This would be subject to anti-avoidance provisions to protect against abuse or against hiding a large termination payment in superannuation.

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4. Regime to be defined by unpublished regulations

The crux of the bill is in the definition of termination "benefit" and "base salary". Neither are defined other than by reference to proposed unpublished regulations (amendments 1, 7 and 10). Your Committee ought to have the opportunity to review the bill with the regulations to fully examine the proposed regime.

We request the opportunity for consultation in relation to these definitions as they are technical and far-reaching. In particular we submit that these regulations ought to require a Regulation Impact Statement to enable proper review and consultation. We do not accept that the "Government's prior announcement to progress reforms in this area" is a reason to by-pass this important democratic process.

5. Application of the bill to existing contracts

In contrast to the original exposure draft and media releases, the bill applies to existing employment agreements if these are "renewed or extended; or …for which a variation of a condition of the agreement happens on or after commencement" (amendment 43). The Explanatory memorandum states that changes to "any term relating to remuneration" would be considered a variation of a condition (paragraph 2.7). We interpret this to mean that any change to pay (including Rio Tinto's recent executive pay freeze and bonus deferral) or alterations to share plans or long term incentives (including enhanced performance conditions) would bring an existing contract within the requirement for shareholder approval in the event of termination.

Unlike the Government's original proposal, this bill does not apply only to new executive contracts which can be designed within the parameters of the new regime to reflect current community concerns. In effect the bill would apply retrospectively to existing contracts in many instances, despite the contrary statement in the Explanatory memorandum (paragraph 2.6).

The bill gives rise to other concerns about workability for Australian companies, particularly those which operate internationally. Rio Tinto endorses the comprehensive submissions by the Business Council of Australia and Chartered Secretaries Australia.

Yours sincerely

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